



Canadian Small Cap Fourth Quarter, 2008

The fourth quarter of 2008 was the worst quarter in the history of the BMO Small Cap weighted Index, capping off the worst year in the history of this small cap index, a history which dates back to the beginning of 1970. In the fourth quarter, the BMO Small Cap Weighted Index was down 27.8%. For 2008, it was down 46.6%. All 10 sectors of the small cap market were down in the quarter and, most assuredly, for the year. This year saw the reversal of the gains generated by the index since mid-2003. The portfolio comfortably outperformed its benchmark in the fourth quarter and for the year.

During the quarter, we eliminated two names from the portfolio, each of which was a smaller weighted position: Horizon North Logistics Inc. and Solium Capital Inc. More importantly, we actively added to our holdings in many of the other names in the portfolio. Stocks in the small cap market tend to be illiquid, tightly held and therefore often tough to buy. But, as we mentioned last quarter, in bear markets, investors are often forced to, or choose to, sell shares of good quality companies at low prices. In the fourth quarter, as the selling got frantic and many securities were indiscriminately sold into the market, we methodically pursued our strategy of selectively adding to our positions in high quality, but oftentimes illiquid, securities. This strategy had nothing to do with trying to call the bottom of the market, but everything to do with trying to buy high quality small cap securities at what we believe to be very reasonable prices.

We foresee a tough economic period in 2009, especially for the US economy, which is indelibly linked to our Canadian economy. However, with the drastic pullback in small caps in 2008, we believe that the market is already discounting much of this economic malaise. We expect the small cap market to be volatile in 2009, but overall see it providing modest returns until the market gains confidence that an economic recovery is on its way. While we are not sure this will happen in 2009, we do know that small caps have historically performed very well coming out of a recession. As such, we have systematically worked to create a strong portfolio that will not only be resilient during this indeterminably long period of economic malaise but will also provide considerable upside when the economic recovery occurs.

Going into 2009, we are heavily weighted in the Industrials sector, where we believe several of our selections will be supported by the trend towards infrastructure spending. This includes IBI Income Fund, an engineering and professional services firm focused on the planning and development of cities, and Bird Construction Income Fund, one of Canada's most successful general contracting firms. We have built up our weight in the Financials sector, adding to many fundamentally strong niche companies, including Altus Group Income Fund, Canada's largest independent provider of commercial real estate consulting and advisory services. We continue to have a meaningful weight in the Energy sector, with an emphasis on competitively-advantaged energy services firms, including ZCL Composites Inc., North America's leading manufacturer of underground storage tanks. Over one-third of the portfolio is comprised of income trusts and other flow-through entities. This weight is simply due to the fact that these companies possess the business models, cash flow generation and valuation characteristics that we seek.

The Summit Program

